KPMG

CECL Pulse check

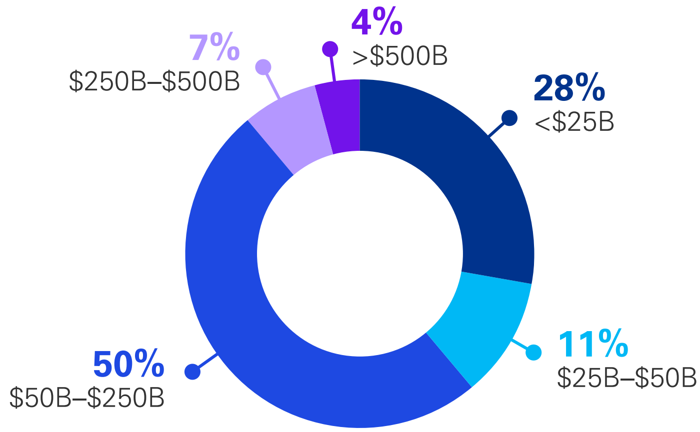
How companies are responding to economic impacts in their CECL estimates in Q3'24

We surveyed companies during the third quarter of 2024 to understand how current economic conditions are likely to impact their Current Expected Credit Losses (CECL) process. We asked about the continuing economic impacts of the current macroeconomic environment and how these forces are likely to affect CECL allowances.

Economic uncertainty continued in the third quarter of 2024 as market pressures persisted. KPMG LLP (KPMG) surveyed commercial and consumer lenders, including banks and finance companies, to understand how companies are dealing with these issues and their impact on CECL estimates. The survey results were obtained between September 12 and September 25, 2024, and reflect information known at that time. As the economic situation evolves, we expect companies will continue to monitor and reassess the assumptions used in their CECL estimates up to the reporting date.

Who we surveyed

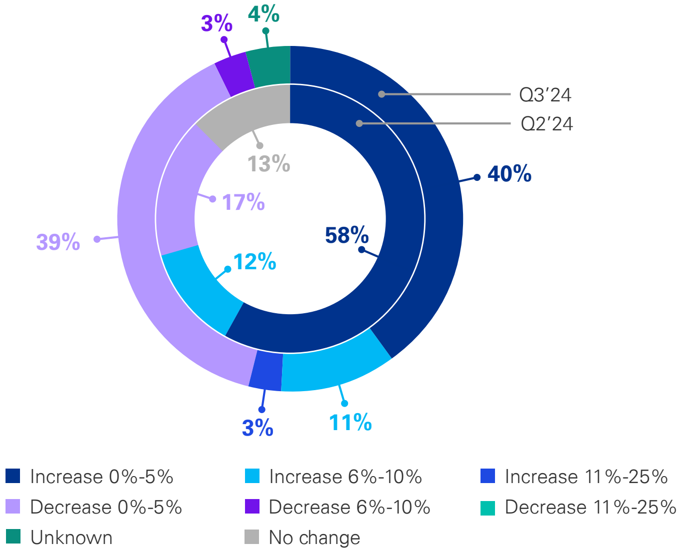
We surveyed **22 banks** and **6 finance companies** with varying asset sizes.



Responses for Q3'24 were obtained between September 12 and September 25, 2024, and reflect information known at that time.

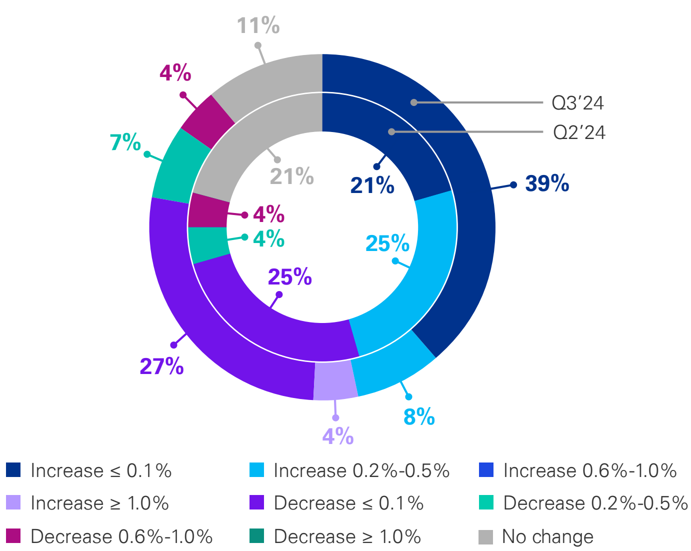
Expected impact of continued economic uncertainty on CECL methodology and results

1. How much do you expect the allowance for expected credit losses (ACL) to change from June 30, 2024 to September 30, 2024?



In Q3'24, approximately 54 percent of respondents expect the overall ACL to increase, compared with 70 percent in Q2'24. In contrast, 42 percent of respondents expect a decrease in their ACL in Q3'24, compared with 17 percent in Q2'24.

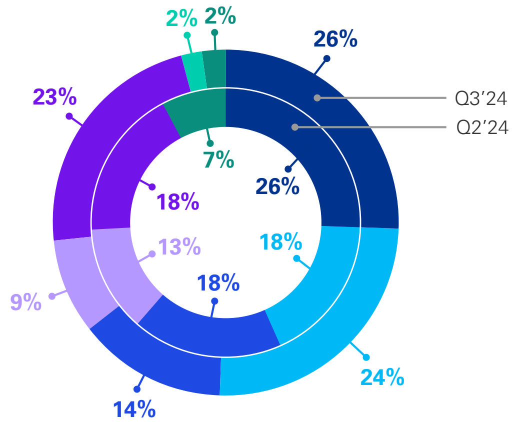
2. How much do you expect the total ACL to change as a percentage of end of period receivables subject to ACL from June 30, 2024 to September 30, 2024?



In Q3'24, approximately 39 percent of respondents who expect the overall ACL to increase expect the increase as a percentage of total receivables assessed for ACL to represent 0.1 percent or less (as compared to 21 percent in Q2'24). Approximately 8 percent of respondents expect the increase to represent 0.2 percent to 0.5 percent (as compared to 25 percent in Q2'24). In contrast, 27 percent of respondents expect the decrease as a percentage of total receivables assessed for ACL to represent 0.1 percent or less (as compared to 25 percent in Q2'24). Approximately 7 percent of respondents expect the decrease to represent 0.2 percent to 0.5 percent (as compared to 4 percent in Q2'24).

Approximately 11 percent of respondents in Q3'24 expect no change in the overall ACL as a percentage of total receivables assessed for ACL (as compared to 21 percent in Q2'24).

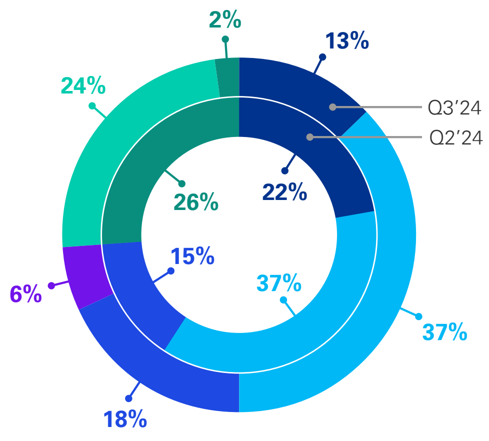
3. What do you expect the largest driver of change to be in the ACL balance excluding changes in loan volume from June 30, 2024 to September 30, 2024?



■ Changes in expectations about the future economic conditions
■ Changes in charge offs
■ Changes in qualitative adjustments based on changes other than changes in expectations about the future economic conditions
■ Changes in individually assessed reserves
■ Changes in asset quality
■ Change in underwriting
■ Other

The largest driver of ACL change, excluding changes in loan volume, was changes in expectations about future economic conditions. Approximately 26 percent of respondents in Q3'24 selected this driver, which is consistent with Q2'24. This was followed by changes in charge offs, with 24 percent of respondents selecting this driver as compared to 18 percent in Q2'24. Other drivers of ACL change included changes in asset quality (23 percent in Q3'24 as compared to 18 percent in Q2'24), changes in qualitative adjustments based on changes other than changes in expectations related to future economic conditions (14 percent in Q3'24 as compared to 18 percent in Q2'24), changes in individually assessed reserves (9 percent in Q3'24 as compared to 13 percent in Q2'24), and changes in underwriting (2 percent in Q3'24).

4. Which economic condition is having the greatest impact on your company's ACL estimate?

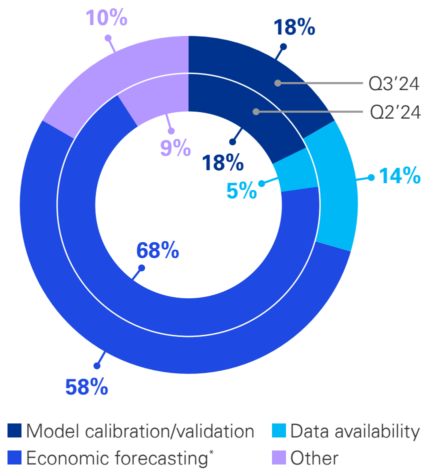


■ Interest rate
■ Economic uncertainty
■ House price index
■ Other
■ Unemployment rate
■ Inflation rate
■ Commercial real estate market index/ Commercial real estate performance index

Responses for Q3'24 were obtained between September 12 and September 25, 2024, and reflect information known at that time. The economic conditions selected may not reflect the impact of more recent market events.

Approximately 37 percent of respondents in Q3'24 cited the unemployment rate as the economic condition expected to have the greatest impact on ACL, which is consistent with Q2'24. Changes in the commercial real estate market and performance indices was the second most significant economic concern in Q3'24, with approximately 24 percent of respondents selecting this economic condition. Economic uncertainty was the third most significant economic concern, with approximately 18 percent of respondents selecting this economic condition in Q3'24, as compared to 15 percent in Q2'24. Interest rate changes followed, with approximately 13 percent of respondents selecting this economic condition in Q3'24, as compared to 22 percent in Q2'24.

5. What is the greatest challenge you are experiencing in determining your company's ACL estimate?



*Economic forecasting as a result of changes in interest rates, unemployment rate, house price and commercial real estate indices, economic uncertainty, and/or other economic factors.

Approximately 58 percent of respondents in Q3'24 stated that economic forecasting as a result of changes in interest rates, unemployment rate, house price and commercial real estate indices, economic uncertainty, and/or other economic factors continues to be the greatest challenge in determining ACL estimates (as compared to 68 percent in Q2'24). Approximately 18 percent of respondents in Q3'24, which is consistent with Q2'24, cited model calibration/validation as the greatest challenge in determining their ACL.

CECL methodology components

To estimate losses over the reasonable and supportable forecast period, entities are permitted to incorporate one or more economic scenarios into their ACL estimate. Accordingly, many institutions have incorporated multiple economic scenarios into their ACL framework, particularly in response to economic uncertainty, interest rate changes, and possible changes in the unemployment rate.

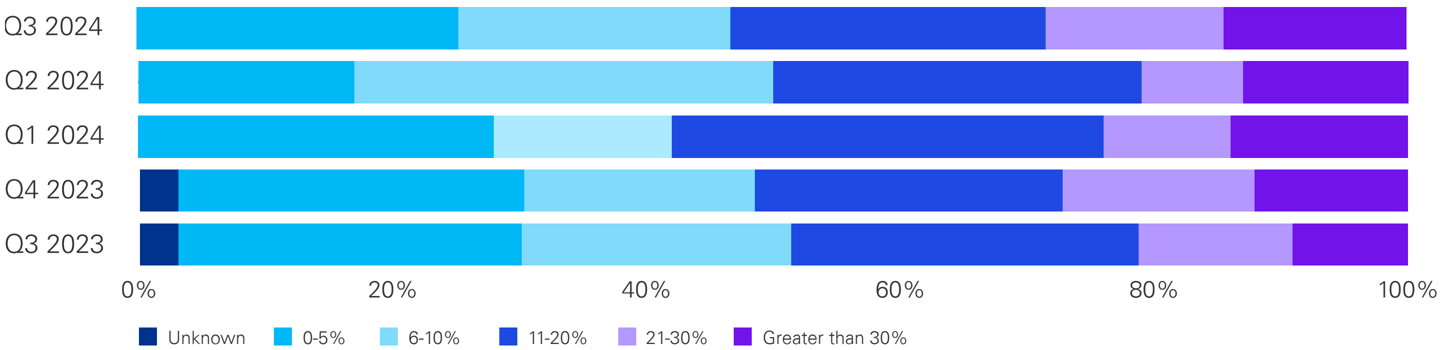
For companies that utilize percentage probability weights in their macroeconomic scenarios as part of their methodology, we have summarized the average percentage probability, where a percentage probability is applied, by the scenario below. For example, for those respondents that applied a percentage other than zero percent to the base case scenario, the average was 60 percent in Q3'24.

	Base case	Upside	Downside	Moderate downside	Severe downside	Other
Q3'24[1]	60%	20%	26%	51%	15%	30%

Examples of where the "Other" scenario has been selected include specific adjustments to reflect current economic conditions and other alternate scenarios informing the loss estimate.

[1] The probability weights do not add to 100 percent given the table represents an average percentage probability by scenario where a percentage probability is applied other than zero percent.

6. What percentage of your company's ACL as of September 30, 2024 would you estimate to be based on qualitative factors?



Many companies incorporate qualitative adjustments into their ACL estimate to capture changes in expectations, and we understand they will continue to do so. Approximately 28 percent of respondents indicated they expect qualitative factors to comprise more than 20 percent of the total ACL estimate in Q3'24 as compared to 21 percent in Q2'24.

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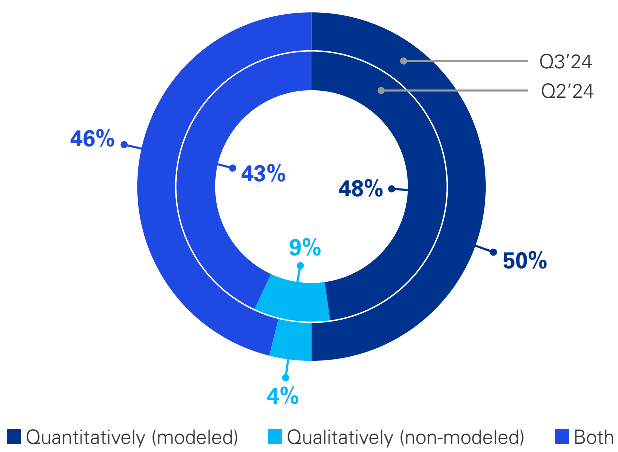
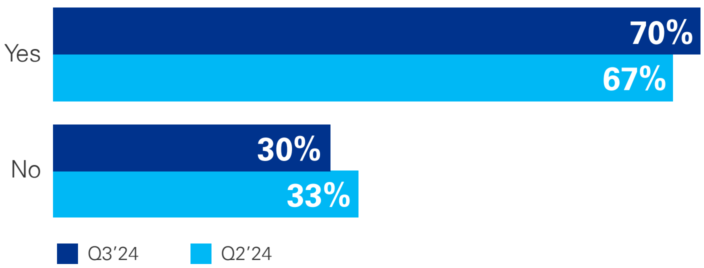
7. How are economic conditions such as changes in interest rates, unemployment rate, house price and commercial real estate indices, economic uncertainty, and/or other economic factors being factored into your company's ACL estimate?



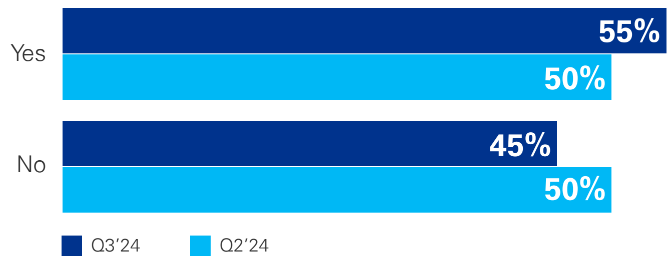
In Q3'24, approximately 46 percent of respondents say they are factoring in impacts from interest rate changes, the unemployment rate, house price and commercial real estate indices, economic uncertainty, and/or other economic factors within their ACL estimate, both quantitatively (modeled) and qualitatively (non-modeled) as compared to 43 percent in Q2'24. In contrast, 50 percent of respondents in Q3'24 are factoring in these same impacts solely via the quantitative (modeled) component of the ACL estimate (as compared to 48 percent in Q2'24).

Delinquencies and net charge-offs

8. Have delinquencies increased from prior quarter end?

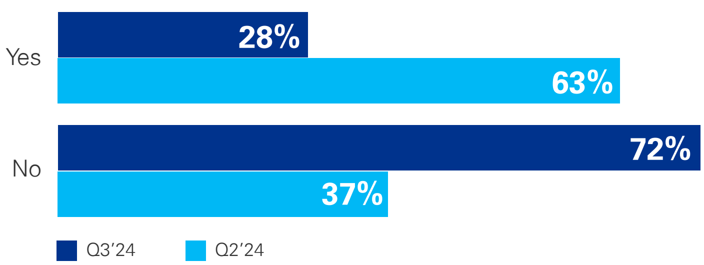


9. Have net charge-offs increased from prior quarter end?



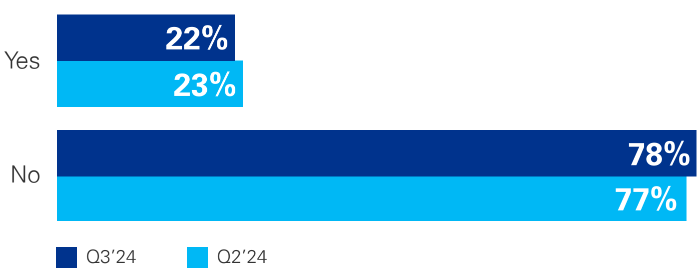
We surveyed companies about delinquency and net charge-off trends, and approximately 70 percent of respondents cited that delinquencies have increased in Q3'24 as compared to 67 percent in Q2'24. Approximately 55 percent of respondents cited net charge-offs also increased in Q3'24, as compared to 50 percent in Q2'24.

10. Have non-performing commercial loans increased from prior quarter end?



Approximately 28 percent of respondents cited that non-performing commercial loans have increased in Q3'24, as compared to 63 percent in Q2'24. Of those who responded, 40 percent in Q3'24 identified commercial and industrial loans as being the primary non-performing commercial loan type (as compared to 35 percent in Q2'24).

11. Are current delinquency and net charge-off rates indicating new portfolio trends as compared to historical experience?



Approximately 78 percent of respondents in Q3'24 have not identified new trends in the most recent delinquency and net-charge off rates, as compared to 77 percent in Q2'24.

Conclusion

Uncertainty surrounding the current macroeconomic environment continues to be a challenge in determining CECL estimates. Analysts and investors will want to understand the key drivers behind the CECL estimates, which include a significant level of estimation and judgment. Companies will need to explain and support their assumptions and estimates of the CECL methodology components, including quantitative models and qualitative factors. We encourage companies to work closely with their boards of directors, auditors, and advisors as they prepare for reporting in the third quarter of 2024.

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